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SUBJECT: SCENESETTER FOR HFAC CHAIRMAN BERMAN'S VISIT TO CHINA

REF: STATE 74770

(U) Sensitive but unclassified. Please handle accordingly.

¶1. (SBU) Chairman Berman, your visit to China comes in a year filled with key anniversaries and events: January 1 marked 30 years of U.S.-China diplomatic relations; March saw the 50th anniversary of the 1959 Tibetan uprising and the Dalai Lama's flight to India; June 4 marked the 20th anniversary of the Tiananmen Square massacre; July saw tragic ethnic violence in Xinjiang; our new State/Treasury-led Strategic and Economic Dialogue with China took place July 27-28; and October 1 will mark the 60th anniversary of the founding of the PRC. The breadth of issues on which we engage China diplomatically has increased dramatically over the past thirty years to encompass a wide range of bilateral and multilateral issues. We seek a mature relationship with China -- a relationship where our leaders can talk frankly about issues where we disagree, such as human rights, while also constructively engaging on vital issues of mutual concern like energy security, the environment, the global economic situation and regional security.

Bilateral Relations

¶2. (SBU) We are working to build a positive, cooperative and comprehensive relationship with China. The Chinese appreciated that Secretary Clinton included China in her first visit abroad as Secretary of State. President Obama had a successful first meeting with President Hu Jintao in London at the G-20, addressed senior U.S. and Chinese policymakers at the Strategic and Economic Dialogue in Washington, and has accepted Hu Jintao's invitation to visit China later this year. The Chinese place great importance on our bilateral links and are pleased with our enhanced Strategic and Economic Dialogue. We have serious and improving engagement with the Chinese on hot-spot issues. Despite the current freeze in the Six-Party Talks on the denuclearization of the Korean Peninsula, China's leadership of and participation in the Talks show that we can engage constructively on vexing issues. We continue to push for increased PRC cooperation on Iran, Pakistan, Afghanistan and Sudan. Your interlocutors would benefit from hearing your ideas on such issues and your suggestions on how inter-parliamentary exchanges can boost the overall relationship.

The U.S.-China Strategic and Economic Dialogue

¶3. (U) The July 28-29 Strategic and Economic Dialogue, led by Secretary Clinton and Secretary Geithner on the U.S. side and State Councilor Dai Bingguo and Vice Premier Wang Qishan on the Chinese side, reflected the development of a new framework for U.S.-China relations. The Strategic and Economic Dialogue provided a venue for the U.S. and China to deepen cooperation in areas such as a lasting economic recovery; a clean, secure and prosperous energy future;

stopping the spread of nuclear weapons and confronting transnational threats. At the talks both the U.S. and China agreed to take measures to promote balanced and sustainable growth, improve financial regulation and supervision, fight protectionism, and cooperate on reforming international financial institutions. The U.S. and China produced a Memorandum of Understanding that elevates climate change in the bilateral relationship and affirmed the importance of continuing efforts to achieve denuclearization of the Korean Peninsula. The second round of the Strategic and Economic Dialogue will be held in Beijing next year.

Response to the Financial Crisis

14. (SBU) China's financial system was relatively insulated from the global financial unrest, and Beijing's rapid response to the economic crisis has, in general, been responsible and helpful. They have continued to buy U.S. Treasury bills and agency (including Fannie Mae and Freddie Mac) debt and have worked with us in international fora, such as the G-20 Leaders' meetings, as well as bilaterally to promote global financial stability. We have urged China to provide additional resources to the IMF and made clear our support for reforming that institution.

15. (SBU) Chinese exports and export-related investment were hard-hit by the global economic downturn. Exports in the first half of this year were down around 20 percent compared to the same period last year, and foreign investment is flat. What declining exports have taken away, the Chinese government is trying to replace with domestic spending.

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Beijing has announced a series of stimulus plans, including massive infrastructure, social spending, and monetary policy initiatives. These programs are bearing fruit, and domestic government and SOE investment has expanded enough to return China to fairly robust GDP growth (7.1 percent in the first half of 2009). Continued expansion through stimulus and government spending is an issue, interestingly, with which both the United States and China are dealing.

16. (SBU) We have welcomed Beijing's strong actions to stimulate its economy but continue to emphasize the importance of long-term sustainability. We see green shoots in the United States and Europe, but we expect the U.S. savings rate to increase and therefore American consumers may no longer absorb China's excess production. China needs to start rebalancing its economy toward greater domestic consumption. We point out that, as we have seen in the United States, high growth of bank lending and lack of transparency can be a cause for concern. A more flexible exchange rate is one part of a policy mix that can promote more harmonious and balanced growth.

17. (SBU) You will likely hear Chinese concerns that future inflation in the United States could erode the value of their dollar-denominated assets ("please protect China's U.S. investments"). Some of their proposals to supplant the dollar with an alternative international reserve currency appear derived from these insecurities. You may wish to remind your interlocutors that the majority of Treasuries are held by Americans (China holds only about seven percent of outstanding USG debt and fourteen percent of publicly held debt) and make a strong statement indicating our intention to fight inflation so that it does not erode our own citizens' assets. Chinese interlocutors would be interested in hearing the Congressional position on future budget deficits and the future restructuring of Fannie Mae and Freddie Mac.

Business-Related Concerns

18. (SBU) The majority of U.S. businesses operating here remain profitable, especially those that are selling into the

Chinese domestic market. However, despite China's frequent calls to ban "protectionism" and Chinese claims that they have no "Buy Chinese" policy in their stimulus package, U.S. businesses say that the Chinese government puts severe restrictions on U.S. companies' ability to compete successfully for stimulus-related contracts. These biases have exacerbated pre-crisis favoritism for domestic firms through use of unique national standards, requirements to force firms into joint ventures with Chinese partners, slower licensing for foreign firms, and the drafting of selective contract specifications to favor domestic firms. It is valuable to emphasize the reality of the "Buy American" requirements in the U.S. stimulus, including their limited scope. Secretary of Commerce Locke made this point emphatically during his visit here in mid-July.

¶9. (SBU) China's propensity to employ state power in business disputes involving state-owned enterprises is another area of concern for us. The signature recent example of this was the arrest under state secrets laws of Australian and Chinese national staff of the Australian mining concern Rio Tinto, which was involved in complicated discussions, almost all of which to our knowledge was derived from the public record, with Chinese enterprises relating to ongoing iron ore sales and a possible merger/acquisition. There have been other similar cases, including some involving American Citizens, but never at a level similar to that of Rio. (In many respects this was a warning to large Chinese steel companies that the central government will not tolerate corrupt practices in the negotiation of iron ore contracts.) We have made the case to the Chinese that using overly broad interpretations of the state secrets law to threaten and punish foreign business partners is inconsistent with international norms and damages China's reputation and attractiveness as an investment destination.

Labor Issues

¶10. (SBU) With the fallout from the global economic crisis, unemployment is a serious concern. Migrant workers and recent college graduates are particularly affected by the downturn, and failures at export-oriented firms have led to protests in coastal provinces, including one in late July at a major steel works that resulted in the death of a plant foreman. Inland provinces that are the traditional sources of China's estimated 225 million migrant laborers are also being impacted. Labor disputes have been on the increase for several years, but the recent surge in formally filed cases

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may be due to workers' awareness of the protections offered by the new Labor Contract Law, which was enacted in January ¶2008. The risk of broader social disruption will depend on the extent of a global downturn as well as the central and provincial governments' response.

China: A Growing Energy Consumer

¶11. (SBU) In less than a generation, China has become an influential player in international energy markets and is currently the world's fastest-growing energy consumer. In 1990, China's energy use accounted for eight percent of global primary energy consumption. This is expected to rise to nearly 21 percent by 2030. China requires access to adequate energy supplies; oil accounts for about twenty percent of China's current energy mix. China now relies on imports to meet about 50 percent of its fossil fuel needs. It is projected that China will need to import some 60 percent of its oil and at least 30 percent of its natural gas by ¶2020. To strengthen the country's energy security, China has adopted a "go-out" policy that encourages investment by Chinese companies in foreign energy resources. Saudi Arabia, Angola, Iran, Oman, and Russia are China's largest oil suppliers; China has also made deals in riskier locations

such as Sudan, Burma and Iraq to cope with growing demand.

Coal Dominates the Energy Mix

¶12. (SBU) Coal remains China's primary source of energy, accounting for 70 percent of its energy mix and fueling 80 percent of China's electricity production. Dependence on coal has come at a high environmental, economic, and public health cost. By most measurements, more than half of the world's most polluted cities are in China. China's sulfur dioxide, carbon dioxide, and mercury emissions are the highest in the world. According to a recent study by the World Health Organization, diseases caused by outdoor and indoor air pollution in China kill 656,000 Chinese citizens every year. The World Bank estimates that economic losses due to pollution total between 3 and 7 percent of GDP annually. Secretary of Energy Chu spoke eloquently during his mid-July visit here on the importance of close collaboration on clean energy projects.

Energy-Related Opportunities for the U.S.

¶13. (SBU) China's audacious plans to improve energy efficiency coincide with U.S. interests in maintaining energy security and developing opportunities for U.S. companies in the Chinese market. U.S. firms are just beginning to tap into opportunities in China to introduce energy efficiency, pollution control, and clean coal technologies. China is a particularly attractive market because of its significant efforts to adopt clean energy technology even while its economy is becoming more industrialized. China will invest USD 175 billion in environmental protection in the next five years. U.S. companies, as Secretary Locke reminded his interlocutors during his July visit to China, are very competitive in a range of clean energy technologies, including renewable energy, power generation, gasification, energy efficiency, nuclear, and others. Clean energy projects draw on the rich resources of both U.S. and Chinese ingenuity and lead to jobs in both countries. Westinghouse, for example, estimates that several thousand U.S.-based jobs are retained every time China orders another nuclear reactor from them.

Human Rights

¶14. (SBU) The PRC government likes to define human rights broadly to include factors affecting economic and social well-being, pointing out that China's "reform and opening" policies of the past 30 years have coincided with gradual improvements in the quality of life enjoyed by hundreds of millions of Chinese. The Chinese further argue that our focus on individual rights and liberties reflects Western, not universal, values. We respond to this by noting that human rights are indeed universal values, as the Chinese themselves acknowledged when they signed the Universal Declaration of Human Rights. Although personal freedoms for Chinese citizens have expanded over the past three decades (providing what some observers have called "a bigger cage"), the overall human rights situation in China remains poor. We continue to emphasize that the expansion of individual freedoms, respect for the rule of law and the establishment of a free and independent judiciary and press are in China's own interests, and would enable the PRC to better deal with

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social tensions and achieve its goal of building a "harmonious society." Providing a legitimate democratic outlet for political criticism and expressions of social discontent might also help the Chinese reduce episodes of violence by disenfranchised elements of society.

¶15. (SBU) House leaders from both political parties have helpfully faced the human rights situation in China head on.

The late Representative Tom Lantos, a regular visitor to China, gracefully expressed respect for China's long history and rich culture while at the same time reminding Chinese leaders that China could not truly reach its full potential until it also reached international human rights norms. Representatives Chris Smith and Frank Wolf have repeatedly emphasized to the Chinese that religious freedom is a basic human need and that religious adherents make good citizens. Hill leaders have worked with U.S. experts and law schools to promote the rule of law in China.

¶16. (SBU) July's unrest in Xinjiang (like last year's unrest in Tibet) made clear serious problems in PRC rule in its western provinces, as ethnic Uighur and Han Chinese battled one another in ways that might have caught the leadership off guard and will complicate ethnic and religious relations in China. You will hear the Chinese assert that the July 5 riots in Xinjiang were a coordinated act of terrorism. They will claim that U.S.-based Uighur organizations and Uighur activist Rebiya Kadeer were leading actors in fomenting the violence. We have no evidence to support their claims. We have expressed condolences for the victims of the violence and urge the Chinese government to conduct the investigative and judicial response to the violence in a manner that is transparent and open and that respects the human rights of the detained. Hundreds, and possibly thousands, of people have been detained in response to the riots, and we have urged that they receive fair treatment. We also continue to urge the PRC authorities to seek ways to appropriately address the underlying causes of ethnic tensions.

Taiwan

¶17. (SBU) Your interlocutors may raise the Taiwan issue and criticize U.S. arms sales to Taiwan. You may choose to respond by emphasizing our obligations under the Taiwan Relations Act to consider Taiwan's legitimate defense needs and that we believe our sales of defense articles to Taiwan have been conducive to cross-Strait peace and stability. We welcome the improvements in cross-Strait ties achieved by PRC President Hu and Taiwan President Ma Ying-jeou since the latter's May 2008 inauguration. You can encourage Beijing to maintain the positive momentum by accommodating Taiwan's meaningful participation in international organizations, by reducing military deployments aimed at Taiwan, and by continuing to make progress on cross-Strait economic and cultural ties.

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